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# FVCCF UPDATE 95 - 1

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AN INFORMATION RELEASE FOR FISHING VESSEL CAPITAL CONSTRUCTION FUND AGREEMENT HOLDERS

## "Preliminary Report" Eliminated

Only one annual report to NMFS of depository activity is now required - NOAA FORM 34-82 - CAPITAL CONSTRUCTION FUND - DEPOSIT/WITHDRAWAL REPORT (the legal length form which requires detail of all depository transactions). The old "Preliminary Report" form, which was previously due in February each year in order to compile a mandated report to the Internal Revenue Service (IRS), is eliminated. IRS has agreed to accept CCF activity reports from NMFS based on Form 34-82 information.

## Due Date For Deposit/Withdrawal Reports

Since the "Preliminary Report" will no longer be used to report annual agreement activity to the IRS, any NOAA Form 34-82 - DEPOSIT/WITHDRAWAL REPORT not submitted to NMFS by it's due date (30 days after the due date of each year's tax return, including any extensions), must be reported to the IRS as "not received". A full copy of the related year's tax return must accompany each report.

Delinquent or amended Deposit/Withdrawal reports for 1993 (and prior tax years) which reach us by March 15, 1995 (DO NOT FAX THEM!), will be included in the initial report to IRS prepared from data on NOAA Form 34-82. Earlier year (delinquent or revised) reports reaching us by September 1995 will be included in the following report to the IRS.

Non filers will be terminated after one notice under authority of the Merchant Marine Act of 1936, as amended.

## NOAA Form 34-82 Required In Years With No Activity

NOAA Form 34-82, reporting annual agreement activity, is required *every year* until NMFS terminates the agreement. The signed and certified report must be submitted annually to NMFS *even if there was no activity during the year*. A full copy of the year's federal tax return must also be submitted. If some annual reports were not submitted, please send them ASAP.

**Note:** The old "Preliminary Report" was *never* a substitute for filing NOAA Form 34-82.

## NMFS Policy Change: "Verbal" Permission to Withdraw Can No Longer Be Given

The CCF staff will no longer give verbal permission to withdraw funds from CCF depositories. Permission is issued only in writing and after:

- \$ A written request is received (we suggest that requests be sent 45 days in advance);
- \$ All Schedule B objectives are updated (include statement that all information is current),

- \$ The file is up dated for the status of Schedule A vessels, depositories, representatives, Deposit/Withdrawal reports, and
- \$ All file deficiencies are corrected. (Note that some documents may take several weeks to obtain, e.g., Coast Guard Form CG-1270.)

One easy way to communicate changed information in Schedule A vessels or Schedule B objectives is to photocopy the existing page and note changes in ink. Sign and date the modified schedule and attach it to your letter.

Permission to withdraw will be given for projects scheduled to begin less than twelve months in the future. A new permission letter, superseding and voiding the old letter, may be issued for projects not yet begun.

"Verbal" approvals for withdrawal from Program staff, given before the policy was changed, will be honored. Written permission for these "verbal" approvals will be issued as they come to our attention in the normal course of business. As before, any permission to withdraw - written or verbal - is contingent upon complying with terms of the agreement, the Merchant Marine Act, the Internal Revenue Code, and regulations under 50 CFR and 26 CFR.

This new NMFS policy supersedes any previous written information disseminated to agreement holders and their representatives, including FVCCF UPDATE 94-2. Frankly, we are struggling under the workload that this policy has already generated. The result, however, will be full documentation of agreement activity. This will be needed in case of audit by the IRS.

See NMFS/CCF regulations under 50 CFR ' 259.33(d) for guidance on NMFS ratification of withdrawals (as qualified) made without first having obtained consent for withdrawals. If you request that a withdrawal be ratified as qualified, send complete details with your written request. The agreement file must still be updated before the withdrawal will be ratified.

#### To Expedite Permission Letters - Review Agreement Documents Now

When our files contain all required documents, we can expedite processing of the items you need, like letters of permission to withdraw funds. We suggest that you review CCF records as a part of your year-end tax return preparation to determine whether NMFS has received all needed paperwork. Please make this determination based on *your* records. Due to CCF workload, Program staff cannot conduct this review for you.

At a minimum, update NMFS records on the following items:

- \$ Status of all Schedule A vessels.
- \$ All documentation required by earlier withdrawal letters (covering *all* agreement objectives). These documents should be submitted as soon as available, and no later than 60 days after the *work on the* planned objective is completed. Examples include Coast Guard documentation and certificate of vessel cost. Also, permanently keep proof of vessel cost for your files. This will be needed if NMFS or the IRS audits your agreement.
- \$ A Schedule A for any vessel constructed or acquired. If a Schedule B objective includes payment of original debt incurred for that objective, send NMFS loan documents and an amortization schedule.
- \$ Status of each Schedule B objective.

Safety Regulations Not Yet Finalized

CCF funds may not yet be used for safety equipment unless it is a part of a qualified Schedule B vessel reconstruction. Regulations may soon be finalized to allow the use of CCF funds for safety equipment without meeting usual minimum expenditure requirements for a reconstruction (20 percent of vessel cost), however, these Regulations involving safety equipment must be approved by the Department of Commerce and the Office of Management and Budget before we can permit the use of CCF funds for safety equipment. We cannot predict when, or even if these regulations will be implemented.

We believe the safety regulations, if approved, will be retroactive. However, it appears that some agreement holders believe that these regulations are already effective. Any agreement holder who has already withdrawn funds for safety equipment without also meeting minimum expenditures required for a reconstruction should call Mary Ellen McMillin (301) 713-2393 (Ext. 120).

Internal Revenue Service Audits

In order to support agreement holders for CCF issues under audit, we need to be informed of the audit while it is in progress. A form is available from us which will allow the IRS to provide information to us about CCF issues during and after an audit.

If you are notified that a tax return with CCF activity (deposits, withdrawals, income from investments, etc.) will be audited, please make certain that your CCF agreement file is up to date so that we have information necessary to make deposit and withdrawal determinations.

If you wish to make a "deficiency deposit" under Joint Regulations from additional taxable income as determined by audit, we should become involved during the audit to help make certain that the deposit will satisfy requirements in NMFS and joint regulations.

Call Mary Ellen McMillin (Ext. 120) to discuss audit issues and information needed.

Termination Requests

We have received a number of requests for termination. We will process these as staffing time permits. Since we may not be able to respond before you need to file your 1994 tax return, some general guidelines follow:

- \$ For terminations requested in 1994, you are required to submit NOAA Form 34-82 Deposit/Withdrawal Report for 1994 showing all depository activity, including any withdrawal required to bring the depository balance to zero. (Terminations requested prior to 1994 should follow all instructions below, except that the 1994 D/W report and tax return is not required.)
- \$ The Federal tax return for the year of termination should reflect the added tax calculation for a nonqualified withdrawal for:
  - \$ Any tax deferred deposits remaining in the account, and
  - \$ Any withdrawals not spent on approved Schedule B objectives. (Do not include withdrawal of depository earnings in the year they were earned if these earnings were recognized on your tax return.) See page 5 for additional information on investment or bank fees paid from this account.
- \$ Submit all required forms and schedules not previously sent to NMFS. These may include:
  - \$ A copy of Coast Guard documentation/registration
  - \$ Statement of actual vessel cost for vessel acquisition
  - \$ Certificate of cost of construction or reconstruction
  - \$ Evidence of indebtedness relating to Schedule B objectives
  - \$ Proof of meeting conditional fishery requirements
  - \$ Schedule A form for new vessel, once it is placed in service

You may wish to review your agreement with your accountant or financial advisor to identify missing documentation. A full review done before preparing the current year tax return should minimize the need to file an amended return for the terminating year. If all required paperwork is in our files, we can expedite the termination. Please send this information to the attention of Elizabeth Brown. Please call her with questions on termination at (301) 713-2392 (Ext 124).

#### Quota Shares, IFQs, ITQs, etc

Quota shares may not be purchased with CCF deposits. Section 607 of the Merchant Marine Act, which defines the CCF Program, requires that funds be used for vessels, and that the tax-deferred income be recaptured through depreciation. Legislative action will be required to expand the language of the Act before we can qualify withdrawals for the permits. To date, we know of no such action being initiated.

Check with your tax advisor or the IRS for additional information. Generally, quota shares are considered to be intangible property rights, similar to a license. The cost of intangible property is amortized, not depreciated for tax purposes.

#### Depository Balances Must Not Exceed Schedule B Objectives

We recently become aware that the depository balances for some agreements exceed open Schedule B objectives. The balance that exceeds open Schedule B objectives may be treated as nonqualified withdrawals (taxed at the highest marginal rate plus interest).

Please review agreement objectives and bring them up to date. "Open" Schedule B objectives exclude Schedule B vessel cost when there is no remaining tax basis (for mortgage payments) and planned objectives for which the projected completion date has passed without activity. Sometimes the cost of planned objectives is underestimated on the Schedule B, as well, especially for reconstructions.

Occasionally we find an agreement with a depository balance and no objectives on file. If this situation cannot be cured, the agreement must be terminated. The remaining balance is treated as a nonqualified withdrawal.

#### Minimum Annual Deposits Required

Projected objective costs should not be set higher than is realistic because of the required annual deposit. Refer to Section 9 in the FVCCF brochure distributed in May, 1994 for details.

#### Schedule A Vessel Required To Keep CCF Agreement Active

Notify us of any Schedule A vessels no longer owned or leased, and any vessel that is no longer used in commercial fishing.

After the last agreement vessel ceases to be used in commercial fishing, an agreement may generally be continued for only three years before the agreement must be terminated. The three year period is allowable only when there is a plan for a new vessel which is a "firm representation of the applicant's actual intentions. Vague or contingent objectives will not be acceptable." (CCF Regulations at 50 CFR Section 259.30(a).

Since an involuntary termination may trigger nonqualified withdrawals, careful planning is needed to use depository balances while qualified objectives are still available.

#### Fees - Further Explanation

Bank, tax preparation, and investment fees may not reduce the depository balance. To the extent that a depository funds generate income (usually interest), that income may be used to pay the fees.

#### Transfers to Closely Held Corporations

Transfers of **depository funds**: Special permission is needed for each transfer of funds from an individual to the agreement holder's closely held corporation. Each transfer must meet all of the requirements of IRC Section 351. The corporation must have it's own agreement and accept all terms

and conditions of the agreement under which the original deposit of funds was made.

Transfers of **agreement vessels**: NMFS must be notified on any transfer of an agreement vessel, including to a closely held corporation, and the agreement must be amended, accordingly.

Questions should be directed to Mary Ellen McMillin (Ext. 120).

CAUTION: Status of CCF Program Joint Regulations

Joint regulations published under 26 CFR Part 3 have not been updated for subsequent legislation and may cause misinterpretations of CCF requirements for certain transactions. One example is the method of dealing with nonqualified withdrawals.

The Departments of Treasury, Transportation, and Commerce have treated certain tax aspects of the Capital Construction Fund Program in final joint regulations (26 CFR Part 3). The Federal Government adopted these in 1976. It has never amended them to reflect subsequent legislative changes affecting the tax aspects of this Program.

You must use caution when applying these final joint regulations. Critical tax aspects of the Program have been changed by subsequent legislation. One of the most important legislative changes involves the tax reporting method, and tax consequences, of non-qualified withdrawals (see section 7518 added to the Internal Revenue Code in 1986). Section 7518 (and all other legislation) supersedes inconsistent provisions of the final joint regulations.

The same Departments also proposed joint regulations about certain tax aspects of the Program not treated in the final joint regulations. The Federal Government proposed these in 1976. It has never adopted or withdrawn them. Regulations do not have the force of law until adopted. At most, these proposed regulations provide the best available evidence of the three Departments' 1976 regulatory intent about certain Program tax aspects not treated in the final joint regulations.

Other aspects of both the final and proposed joint regulations that may be out of date include: tax rates, capital gains rates, and Internal Revenue Code citations.

Tax Guide for Commercial Fishermen - IRS Publication 595

The 1994 IRS Publication 595 includes a slightly expanded explanation of the CCF program. We included a copy of this section in this mailing. The full publication (70 pages of information directed at commercial fishermen) may be ordered by calling 1-800-829-3676.

Revenue Ruling 94-26, released last April, followed reporting instructions previously published in the guide. See UPDATE 94 - 2 for more information.